DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 01-0026
Corporate Adjusted Gross Income—Combined Filing
Corporate Adjusted Gross Income—Unitary Filing
Tax Administration—Penalty
For Tax Year 1998

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Corporate Adjusted Gross Income—Combined Filing: Substantive Requirements

Authority: IC § 6-3-2-2 — 45 IAC 3.1-1-38
IC § 6-3-4-14 — Public Law 86-272
15 USCS § 381

Taxpayer protests the Department's finding that taxpayer may not include a related company in its consolidated return for the tax year at issue.

II. Corporate Adjusted Gross Income—Procedural Requirements for Unitary Filing

Authority: IC § 6-3-2-2(q)

Taxpayer argues that the taxpayer's two subsidiaries meet the standards for filing a combined return.

III. Tax Administration—Penalty

Authority: IC § 6-8.1-10-2.1 — 45 IAC 15-11-2

Taxpayer protests the 10% negligence penalty added to the proposed assessment.

STATEMENT OF FACTS

Taxpayer is a holding company, incorporated in Indiana in 1998. Taxpayer's only income is from management fees from two subsidiaries, one located in Oklahoma, one in Indiana. The Oklahoma subsidiary manufactures curb and air handling units that are then attached to HVAC units. The Oklahoma subsidiary ships the units to the Indiana subsidiary, which is basically a

sheet metal shop; it then manufactures parts for commercial HVAC units that are then sold to commercial distributors. Taxpayer filed a consolidated adjusted gross income tax return for all three entities. The Audit Division disallowed the combined filing based on the Oklahoma subsidiary's lack of income derived from sources within Indiana. More facts will be added as required.

I. Corporate Adjusted Gross Income—Combined Filing: Substantive Requirements

DISCUSSION

Taxpayer protests the Department's finding that taxpayer's Oklahoma subsidiary may not be part of taxpayer's consolidated filing. The applicable statute is IC § 6-3-4-14. Section (a) provides that affiliated groups of corporations "shall have the privilege of making a consolidated return" for taxes imposed by Indiana's Adjusted Gross Income Tax Act. However, there are certain statutorily required conditions that must be met before the Department grants the privilege. First, all the corporations must consent to "all of the provisions of this section including all provisions of the consolidated return regulations" of Section 1502 of the Internal Revenue Code, "and all regulations promulgated by the department implementing this section." Consent is not an issue in this protest; consequently, the relevant regulations apply. *See* discussion, *infra*.

Section (b) of IC § 6-3-4-14 defines affiliated groups in conjunction with Section 1504 of the Internal Revenue Code, with one salient exception: "the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana." The Audit Division determined that the Oklahoma subsidiary did not have adjusted gross income "derived from sources within Indiana." IC § 6-3-2-2(a) defines adjusted gross income derived from sources within Indiana as follows:

> With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:
>
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

45 IAC 3.1-1-38 defines a taxpayer as doing business in a state "if it operates a business enterprise or activity in such state including, but not limited to:

> (1) Maintenance of an office or other place of business in the state

(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
(3) Sale or distribution of merchandise to customers in the state directly from company owned or operated vehicles where title to the goods passes at the time of sale or distribution
(4) Rendering services to customers in the state
(5) Ownership, rental or operation of a business or of property (real or personal) in the state
(6) Acceptance of orders in the state
(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under Public Law 86-272 to tax its net income.

The Oklahoma subsidiary manufactures custom "curbs"--the metal sheds HVAC's sit in--; the Indiana subsidiary orders the curbs exclusively from the Oklahoma subsidiary, as well as ordering standard curbs. The Oklahoma subsidiary ships its entire production of curbs by common carrier to the Indiana subsidiary. The president of the Oklahoma flies to Indiana once a year to negotiate a sales contract. The Indiana subsidiary relies on sales projections in crafting the contract. For custom curbs, employees from the Oklahoma subsidiary go to the Indiana subsidiary to learn exact specifications. All engineering and quality control occurs in Indiana; Indiana employees of the Indiana subsidiary inform "several" Oklahoma employees of the Oklahoma subsidiary, in training sessions, of the required curb specifications. The Oklahoma employees then return to Oklahoma where all manufacturing takes place.

The Oklahoma subsidiary's activities do not fall within the definitions set forth in the applicable statutes and regulations. It has no income from doing business in the state of Indiana; there are only receipts from sales of units manufactured in Oklahoma by Oklahoma employees to the Indiana subsidiary. The Oklahoma subsidiary does not maintain an office or other place of business in Indiana, nor does it maintain any inventory for sale, distribution, or manufacture. There are no consigned goods within the state. Subsection (3) above is not satisfied. The Oklahoma subsidiary renders no services to its only customer within the state, taxpayer's Indiana subsidiary. The Oklahoma subsidiary does not own, rent, or operate a business or property in Indiana. None of the Oklahoma's subsidiary's in-state activities exceed "the mere solicitation of orders" so as to give Indiana nexus with the Oklahoma subsidiary under Public Law 86-272, 15 USCS § 381. Indiana does not have the power to tax the Oklahoma subsidiary for labor conducted in Oklahoma.

FINDING

Taxpayer's protest concerning the Department's finding that taxpayer's Oklahoma subsidiary may not be part of taxpayer's consolidated filing is denied.

II. Corporate Adjusted Gross Income Tax—Procedural Requirements for Filing a Combined Return

DISCUSSION

Secondly, taxpayer argues it should be able to file a combined return. This argument rests on the contention that the Oklahoma subsidiary and the Indiana subsidiary meet the standards for a finding that they are in a unitary relationship. Taxpayer's failure to request the statutorily required permission to file a combined return was based on their mistaken belief taxpayer could file as a small business corporation. Taxpayer admitted this was a mistake, and did not protest that part of the assessment. Taxpayer is now requesting that they be allowed to file a combined return for the tax year at issue because the Oklahoma subsidiary cannot operate without the Indiana subsidiary and its cash flowing to it. Taxpayer essentially argues that both subsidiaries are really one company.

Despite taxpayer's arguments, the Department cannot grant permission for taxpayer to file unitary. Pursuant to IC § 6-3-2-2(q), taxpayer should have petitioned the Department "thirty (30) days after the end" of its taxable year "for permission to file a combined income tax return fro a taxable year." The statute is clear about the thirty-day requirement to file a petition for permission to file a combine return. Taxpayer did not meet its statutory obligation.

FINDING

Taxpayer's protest concerning the procedural requirements for filing a combined return is denied.

III. Tax Administration—Penalty

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that its failure to pay the appropriate amount of tax due was based solely on taxpayer's interpretation of the relevant statutes and regulations.

Indiana Code Section 6-8.1-10-2.1(d) states that if a taxpayer subject to the negligence penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana's tax statutes and administrative regulations.

In order for the Department to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying or failing to carry out a duty giving rise to the penalty imposed. . . ." In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits.

Taxpayer has failed to set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Although some of the questions raised by taxpayer involve technical issues of interpretation and applicability, given the totality of the circumstances, waiver of the penalty is inappropriate in this instance.

FINDING

Taxpayer's protest concerning the abatement of the 10% negligence penalty is denied.

DMF/JMM/MR 021508